

City of Rockville Retirement Board

March 26, 2009

PRESENT: Alex Espinosa, Chairperson; Cpl. Chris Peck, FOP Representative; Anita McCombs, AAME Representative; Phyllis Marcuccio, Councilmember; Carlos Vargas for City Manager. Also in attendance were Gavin Cohen, Executive Secretary to the Board; Daisy Harley, Personnel Administrator; Tim Peifer, Financial Systems Manager; Marsha Mathis, Principal Financial Group; as well as George Kiriakos and Taylor Dabrowski, Segal Advisors.

ABSENT: Kyle France, Union Representative and Gregory Hazlett, Citizen Representative.

The meeting commenced at 10:10 a.m. and started with introductions.

I. Appointment of Chairperson/Welcome New Members to the Committee

Mr. Cohen informed the Board that the new Citizen Representative to the Board was Gregory Hazlett and that he was on a conference to China and could not attend the meeting. He also let them know that a new in-house attorney was hired and her name was Debra Daniel.

II. Approval of Minutes from November 14, 2008:

Mr. Kiriakos stated that there were several changes to be made to the minutes and requested to have the minutes e-mailed to him and he would make the adjustments and send them back. The Board will receive corrected ones once this is done. Mr. Cohen asked the Board if they would prefer action minutes as opposed to verbatim minutes. Mr. Espinosa said he would like a brief summary of each item. Ms. Dabrowski offered to send her memo file within 24 hours of a meeting to help with compiling the minutes and for Board members that were not in attendance to know what happened. Mr. Cohen said that would be greatly appreciated. Mr. Espinosa asked for a motion to approve the minutes subject to the edits to be made. Mr. Vargas made the motion and Cpl. Peck seconded. All were in favor.

III. Review of Quarterly Performance Reports October 1, 2008-December 31, 2008:

At this time Ms. Mathis stepped out of the meeting.

Mr. Kiriakos discussed the economic market conditions. He discussed how the credit markets worked to set the stage for the reason why the Principal Bond and Mortgage portfolio under performed the Barclays Capital Aggregate Bond Index. As of December 31, 2008 the plan was valued at \$43.0 million, which represented a -32.5% return for the recent year. The Plan under performed the Policy index by 7% (-24.9%), of which Mr. Kiriakos explained the 6% of the under performance was attributable to the fixed income portfolio. The Principal Large Cap Stock portfolio performed in-line with the S&P 500 Index. The Principal International Equity portfolio out paced over the longer periods despite the slight under performance relative to the MSCI EAFE Index for the recent periods. The Manning & Napier Small Cap portfolio under performed the Russell 2000 Index since inception (April 1, 2008), which was a result of the process and philosophy employed by Manning & Napier. The Prudential Real Estate portfolio slightly under performed the NCREIF ODCE Index, yet relative to the equity markets the under performance was not as great.

The Board decided that despite the "bundled" approach they have with Principal, they want to conduct a search to replace the Principal Bond & Mortgage Fund. Segal also discussed the potential option of hiring a transition manager to assist with the transition to the new manager.

The Thrift Plan was discussed next. There was not a significant shift in the asset allocation for the recent quarter. Ms. Dabrowski discussed that there was slight transfers into the Money Market and Guaranteed Accounts from the equity portfolio. In addition, there was approximately a 3% increase in contributions to the Stable Value options during the recent quarter. The same Principal Bond & Mortgage Fund is in the Thrift Plan as a core option and the Fund has allocations in the Balance option and the Principal Lifetime Funds. Ms. Dabrowski discussed that the more conservative Lifetime Funds suffered more significant underperformance as a result of the greater allocation to fixed income. In addition, Ms. Dabrowski discussed the changes to the Lifetime portfolios, of which, Principal added PIMCO as a complement to the

Principal Fixed Income portfolio and they lowered the expense ratio by 3 bps.

During the presentation, Ms. Dabrowski discussed the revisions to the Guidelines specifically the criteria to have a fund be placed on the Watchlist. There were some slight changes requested by the Board. Ms. Dabrowski will make the changes and send them to Mr. Cohen for final approval.

After a lengthy discussion, the Board decided to place the following funds on the Watchlist: The Principal Mid Cap Stock Fund (will remain on the Watchlist), Principal Stock Emphasis Balanced Fund and the Principal Lifetime Funds (all funds).

The Board also decided to conduct a fixed income investment search to replace the Principal Bond & Mortgage Fund. The Board would like to accelerate the process and have a conference call to decide on a replacement.

Ms. Mathis returned to the meeting. Ms. Mathis from Principal discussed the recent performance of the Principal Bond & Mortgage Fund portfolio and the current financial situation of the Principal Financial Group. She discussed that the underperformance was a result of the under weighting in treasuries in the portfolio. She noted that the fund has been placed on their internal Watchlist. She also noted that the process and philosophy of the fund has not changed and there have not been changes to the fund management team.

At this time Ms. Mathis stepped out of the meeting.

Following Ms. Mathis's presentation, the Board discussed that there was "too much" Principal and felt that as Fiduciaries they needed to review alternative options. Segal discussed a vendor search and what that means. The Trustees decided that they wanted to move forward with the vendor search and requested that Mr. Kiriakos present them with a proposal for a vendor search.

IV. Retiree Benefit Trust – GASB 45:

The OPEB Trust is a new Trust with an initial funding of \$1.3 million. The Trustees hired Segal to conduct an asset allocation study as well as present them with some options as it relates to the implementation. Segal presented the asset allocation study with an initial allocation as well as a longer term asset allocation strategy. The reason they presented two asset allocation strategies is that this is a start up Plan with an initial funding of \$1.3 million and investment strategies will be different in the short term and the long term. Every other year following, there will be a contribution of \$1 million. However, there will be no withdrawals from the Plan in the first 5 years and they have an actuarial earnings assumption of 8.0%. The Trustees decided on an initial allocation of 80% large cap equity and 20% fixed income. The Board decided to invest with the Manning & Napier Long-term Growth Strategy.

Ms. Marcuccio moved to approve Trust document. Cpt. Peck seconded.

Ms. McCombs motioned to pick Manning & Napier as fund managers and Cpl. Peck second.

Items V, VI, VII, and VIII. were deferred until the next meeting.

Ms. McCombs made a motion to adjourn at 2:15 p. m. Cpl. Peck seconded. All were in favor.